

VZCZCXRO4448
RR RUEHCN RUEHGH RUEHVC
DE RUEHHK #1261/01 1930747
ZNY CCCCC ZZH
R 110747Z JUL 08
FM AMCONSUL HONG KONG
TO RUEHC/SECSTATE WASHDC 5286
INFO RUEHOO/CHINA POSTS COLLECTIVE
RUEATRS/DEPT OF TREASURY WASHDC
RHEHNSC/NSC WASHDC

C O N F I D E N T I A L SECTION 01 OF 02 HONG KONG 001261

SIPDIS

STATE FOR EAP/CM, EEB FOR OMA; TREASURY FOR DOHNER; NSC FOR
WILDER AND TONG

E.O. 12958: DECL: 07/08/2028

TAGS: [ECON](#) [EFIN](#) [PGOV](#) [HK](#)

SUBJECT: NEW FINANCE AND TREASURY UNDERSECRETARY ASSAILS
PAN-DEM POLITICKING

Classified By: Deputy Principal Officer Chris Marut, Reason 1.4 b

¶1. (C) Summary: Newly appointed Undersecretary for Finance and the Treasury Julia Leung criticized the political controversy that surrounded the appointment of the six Political Undersecretaries, their salaries and their passports (discussed septel). In a recent meeting with the Deputy Principal Officer and Econ Unit Chief, she claimed she had been considering giving up her British passport even before the controversy erupted. Her priorities will include managing efforts to expand and diversify Hong Kong's financial services sector. Leung said competition from Chinese regulatory agencies eager to protect their own interests derailed the "Through-Train" scheme that would allow mainland residents to invest directly in the Hong Kong stock market. While Hong Kong's Hang Seng index has fallen over 20% this year, the subprime crisis is not really affecting most Hong Kong banks. HKMA Joseph Yam's recent warning to banks to avoid deals that involved property companies "topping up" mortgage loans to cover up to 90% of the purchase price has, according to Leung, prevented borrowers from becoming over-leveraged. Leung will leave her current position as Executive Director at the Hong Kong Monetary Authority on July 25 and take up her new responsibilities in early August. End Summary.

¶2. (SBU) Comment: Leung has been a valuable interlocutor for the United States in her role as Executive Director (International) at HKMA, regularly providing frank insight into HKMA positions and relations with the Chinese financial authorities. Of all of the newly appointed Undersecretaries, she is among the most qualified to take up her new position. Nevertheless, she has been criticized by pan-Democrats as one of Norman Chan's "proteges." (Note: Prior to becoming chief of staff for Chief Executive Tsang, Chan was Deputy Director of the HKMA and has been tipped as the favorite to succeed HKMA Chief Executive Joseph Yam when Yam is forced to retire in 2009. End note.) While not a political party member, Leung's appointment makes her a strong candidate for a Secretary-level position in the next administration. End Comment.

¶3. (U) Deputy Principal Officer and Econ Unit Chief met June 27 with newly appointed political Undersecretary for Finance and Treasury Julia Leung. Leung is currently the Executive Director (International) at the HKMA but will resign that position July 25 and assume her new duties on August 11. Leung was a journalist with the Asian Wall Street Journal before joining HKMA in 1994, rising to her current position in 2000.

=====
Politics, Not Substance, Driving Criticism
=====

14. (C) Leung observed that the political Undersecretary appointment process had become far too politicized. Although she expected the political appointees to be scrutinized closely, the furor over salaries and foreign passports was clearly driven by election year politicking. She noted that there is no requirement in the Basic Law for Undersecretary-level appointees to give up their foreign passports, but that she had been considering doing so since she learned of her appointment and it was not a difficult decision. (Note: Leung and her two children became UK citizens through her husband, a Hong Kong civil servant and a senior manager at Radio Television Hong Kong (RTHK) who was offered British citizenship prior to 1997. End Note.)

15. (C) Criticism of the government's selection process as non-transparent is misguided, said Leung. Nominations for political Undersecretaries were accepted from individuals or groups. These were vetted and a short-list of candidates was interviewed by a panel that in her case included Chief Executive Tsang, Tsang's chief of staff Norman Chan, Financial Secretary John Tsang and Finance and Treasury Secretary KC Chan, among others. Leung dismissed criticism that Norman Chan's proteges dominated the Undersecretary appointments. Of all those appointed, she is the only one who worked directly with Chan for any length of time while both were senior officials at the HKMA. The objections by the pan-Democrats about passports, salaries, and ties to Norman Chan are driven by electoral politics in the run-up to the September Legislative Council elections, she said.

16. (U) Given her experience at HKMA, Leung expected that promoting Hong Kong's financial services sector would be her

HONG KONG 00001261 002 OF 002

primary focus as Undersecretary. Hong Kong is uniquely positioned to become the premier financial services provider to a large and rapidly developing hinterland, much as New York relies on the rest of the United States and London relies on European business. The dipping equity markets combined with consistent renminbi appreciation has cooled Chinese companies appetite for international stock listings, she said. In the near term, Hong Kong must seek to diversify its financial services sector and seek business opportunities in Southeast Asia, the Middle East, Russia and other emerging markets. The newly announced plan to launch Hong Kong Depository Receipts is a good way to begin to tap these new markets. Hong Kong authorities are also seeking to offer Islamic financial services, she said.

=====
Through-Train Not Likely to Get Back on Track Soon
=====

17. (C) In response to questions about the "Through-Train" scheme to allow mainland residents to invest directly in the Hong Kong Stock Market, Leung replied that the scheme was derailed by competition from Chinese regulatory agencies eager to protect their own fiefdoms. The Chinese Banking Regulatory Commission (CBRC), State Administration for Foreign Exchange (SAFE), and the Chinese Securities Regulatory Commission (CSRC) all supported the concept, she said, but couldn't agree on the mechanism. Before they could reach agreement, the market shifted and demand for Hong Kong equities dried up. Hong Kong's market can compete with Shanghai, but not with Chinese regulators, she said. CSRC is still strictly controlling Chinese company applications to list in Hong Kong; while they have told HKMA they will relax restrictions, it is likely to take some time, said Leung.

=====
Hong Kong Dodges Subprime/Real Estate Bubbles
=====

18. (U) The subprime crisis in the U.S. is not really affecting most Hong Kong banks, she said. Although equity markets are down sharply and financial services companies are

not seeing much new business, most have posted only minimal losses so far. (Note: Hong Kong's Hang Seng Index has fallen by over 20% since the beginning of 2008. End Note.) Much of the emerging market equity price increase in 2007 was speculative and was a result of capital flight from developed markets. As that capital has moved on in search of higher returns, most emerging market equities are returning to more sustainable levels, she said. Most Hong Kong banks and financial service companies are not highly leveraged nor were they heavily exposed to structured debt products. Bank business in Hong Kong appears to be reasonably good, despite lower rates of growth and higher inflation. However, if prime U.S. assets like FannieMae or FreddieMac are affected by the subprime fallout, Hong Kong-based financial companies will feel some pain, according to Leung.

19. (U) The rapid flow of capital into Hong Kong in the second half of 2007 had some regulators worried that equity and property price bubbles could create problems for the Hong Kong economy. Hong Kong luxury property prices moved past their 1997 peaks late last year. Low U.S. interest rates and rising inflation mean that Hong Kong's real interest rates are now negative. In spite of this, the new property market has remained relatively stagnant. Hong Kong investors have been through this before, said Leung. HKMA Chief Executive Joseph Yam's recent warning to banks to avoid deals that involved property companies "topping up" mortgage loans to cover up to 90% of the purchase price had effectively stifled these offers and prevented borrowers from becoming over-leveraged. Banks have improved their due diligence, making defaults unlikely, she said.
Cunningham